

**METROPOLITAN LYNCHBURG -
MOORE COUNTY
WATER AND SEWER DEPARTMENT**

Lynchburg, Tennessee

June 30, 2008

WINNETT
Associates, PLLC

Certified Public Accountants and Consultants

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INDEPENDENT AUDITORS' REPORT

Members of Utility Board
Metropolitan Lynchburg - Moore County
Water and Sewer Department
Lynchburg, Tennessee

We have audited the accompanying statement of net assets of Metropolitan Lynchburg - Moore County Water and Sewer Department as of June 30, 2008, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the Metropolitan Lynchburg - Moore County Water and Sewer Department and are not intended to present fairly the financial position of Metropolitan Lynchburg - Moore County, Tennessee, and the results of its operations and changes in cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Metropolitan Lynchburg - Moore County Water and Sewer Department as of June 30, 2008, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 20, 2008, on our consideration of Metropolitan Lynchburg - Moore County Water and Sewer Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

Metropolitan Lynchburg - Moore County Water and Sewer Department has not presented the management's discussion and analysis that accounting principles generally accepted in the United States have determined is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The budgetary, bond, insurance, and statistical information are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U. S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of Metropolitan Lynchburg - Moore County Water and Sewer Department. The budgetary, and bond information and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the financial statements taken as a whole. The insurance and statistical information have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Winnett Associates

October 20, 2008

STATEMENT OF NET ASSETS
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

<u>ASSETS</u>			
UTILITY PLANT:			
Utility plant in service - Notes B(2) and C	\$ 12,672,287.79		
Less accumulated depreciation	(2,553,870.22)		
	<u>\$ 10,118,417.57</u>		
Construction in progress	34,860.19	\$ 10,153,277.76	
CURRENT ASSETS:			
Cash - Note D	\$ 143,903.86		
Accounts receivable, net of allowance for uncollectible accounts of \$978.04 - Notes B(3) and J	85,404.85		
Due from Metropolitan government - Note E	32,835.59		
Other receivables	3,450.28		
Unbilled water and sewer charges	71,747.52		
Inventories - Note B(4)	<u>51,508.50</u>		
	TOTAL CURRENT ASSETS	388,850.60	
OTHER ASSETS:			
Utility deposits	\$ 530.00		
Restricted cash - Note D	<u>78,014.77</u>	<u>78,544.77</u>	
	TOTAL ASSETS	<u>\$ 10,620,673.13</u>	
<u>LIABILITIES AND NET ASSETS</u>			
CURRENT LIABILITIES:			
Current maturities of long-term debt	\$ 203,679.71		
Accounts payable	75,276.61		
Accrued wages, payroll taxes, and withholdings	9,124.60		
Accrued interest	9,502.31		
Accrued vacation pay	12,377.66		
Deferred fees	53,122.03		
Customer deposits - Note J	<u>20,361.11</u>		
	TOTAL CURRENT LIABILITIES	\$ 383,444.03	
LONG-TERM DEBT:			
Revenue bonds - Note F	\$ 3,945,472.90		
Less: Deferred loan costs-Note B(5)	(34,213.51)		
Current portion	<u>(54,754.00)</u>		
NET REVENUE BONDS	\$ 3,856,505.39		
Notes payable - Note G	\$ 1,534,046.68		
Less current portion	<u>(148,925.71)</u>		
NET NOTES PAYABLE	\$ 1,385,120.97		
	NET LONG-TERM DEBT	<u>5,241,626.36</u>	
	TOTAL LIABILITIES	\$ 5,625,070.39	
NET ASSETS:			
Invested in capital assets, net of related debt	\$ 4,673,052.09		
Restricted for debt retirement	78,000.65		
Unrestricted	<u>244,550.00</u>		
	TOTAL NET ASSETS	<u>4,995,602.74</u>	
	TOTAL LIABILITIES AND NET ASSETS	<u>\$ 10,620,673.13</u>	

The accompanying notes are an integral part of this financial statement.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

METROPOLITAN LYNCHBURG - MOORE COUNTY WATER AND SEWER DEPARTMENT

For the year ended June 30, 2008

OPERATING REVENUES: - Note F

Water sales	\$ 1,082,700.96	
Sewer service charges	208,107.71	
Penalties	14,920.00	
Service fees	12,150.00	
Sanitation revenue	7,200.00	
Tap connection fees	17,364.24	
Pre-treatment income	9,952.08	
Surcharges	34,300.00	
Miscellaneous	4,705.62	
Uncollectible accounts	(2,446.80)	
	<u>TOTAL OPERATING REVENUES</u>	\$ 1,388,953.81

OPERATING EXPENSES:

General and administrative	\$ 249,669.03	
Water operating expenses	655,702.98	
Sewer operating expenses	139,473.63	
Utility maintenance	164,033.13	
	<u>TOTAL OPERATING EXPENSES</u>	1,208,878.77
	OPERATING INCOME	\$ 180,075.04

NONOPERATING REVENUES (EXPENSE):

Interest income	\$ 8,042.58	
Interest expense	(188,484.81)	
Loss on retirement of fixed assets	(84,208.53)	
	<u>TOTAL NONOPERATING REVENUE (EXPENSES), NET</u>	(264,650.76)
	INCOME (LOSS) BEFORE CONTRIBUTIONS AND GRANTS	\$ (84,575.72)

Tap fees in excess of cost	18,992.86	
Contributions	46,486.27	
Grants	505,659.28	
	<u>CHANGE IN NET ASSETS</u>	\$ 486,562.69
	TOTAL NET ASSETS - BEGINNING	4,509,040.05
	TOTAL NET ASSETS - ENDING	<u>\$ 4,995,602.74</u>

Provision for depreciation and amortization for the year totalled \$325,333.61.

The accompanying notes are an integral part of this financial statement.

STATEMENT OF CASH FLOWS
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

For the year ended June 30, 2008

CASH FLOWS FROM OPERATING ACTIVITIES:

Receipts from customers	\$ 1,394,608.63	
Payments to suppliers	(385,871.28)	
Payments to or on behalf of employees	(508,338.55)	
	<u>NET CASH PROVIDED BY OPERATIONS</u>	\$ 500,398.80

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Acquisition of capital assets	\$ (1,109,128.50)	
Proceeds from disposition of assets	800.00	
Proceeds from long-term debt	2,394,399.29	
Borrowings repaid	(2,209,608.35)	
Contributions and grants in aid of construction	567,688.13	
Interest paid	(210,230.68)	
	<u>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</u>	(566,080.11)

CASH FLOWS FROM INVESTING ACTIVITIES:

Redemption of certificate of deposit, net of reinvestment	\$ 99,918.28	
Interest income	8,042.58	
	<u>NET CASH PROVIDED BY INVESTING ACTIVITIES</u>	107,960.86
	INCREASE IN CASH AND CASH EQUIVALENTS	\$ 42,279.55
	CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	72,922.92
	<u>CASH AND CASH EQUIVALENTS AT END OF YEAR</u>	<u>\$ 115,202.47</u>

RECONCILIATION OF OPERATING INCOME TO NET CASH

PROVIDED BY OPERATING ACTIVITIES:

Operating income	\$ 180,075.04
Depreciation and amortization	325,333.61
Changes in operating assets and liabilities:	
Accounts receivable	(6,611.80)
Other receivables	(29,205.31)
Accrued revenue	(7,771.24)
Inventories	(7,527.53)
Accounts payable	185.99
Accrued wages and payroll taxes	(2,171.53)
Accrued vacation pay	(1,329.11)
Customer deposits and deferred fees	49,420.68
	<u>NET CASH PROVIDED BY OPERATING ACTIVITIES</u>
	<u>\$ 500,398.80</u>

Schedule of noncash capital and related financing activities:

The Department acquired servicing rights and facilities to service a group of customers from another utility in exchange for an installment note of \$142,063.30.

The accompanying notes are an integral part of this financial statement.

NOTES TO FINANCIAL STATEMENTS
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE A - GENERAL

These financial statements include the accounts of Metropolitan Lynchburg - Moore County Water and Sewer Department (the Department). The Department is owned by Metropolitan Lynchburg - Moore County, Tennessee (the Primary Government) and is governed by the Metropolitan Council and a Utility Board composed of members of the Council. The Department does not represent a separate legal entity separate and apart from the Primary Government.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Department conform to generally accepted accounting principles as applicable to enterprise funds. The Department applies all Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB, in which case, GASB prevails. A proprietary activity may also elect to apply all FASB statements and interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. The Department has not elected this option. The following is a summary of significant policies:

(1) Accounting Method

These financial statements have been prepared on the accrual basis of accounting. The Department accrues the unbilled revenue from the dates of the most recent meter readings to the balance sheet date.

(2) Utility Plant and Depreciation

Utility plant in service is reported at cost and includes improvements, with a cost in excess of \$3,000.00, that significantly add to utility plant or extend useful lives. Cost of maintenance and repairs are charged to expense, as are tap connection costs.

Depreciation is calculated by the straight-line method to allocate the cost of the assets over their estimated useful lives using guidelines set forth by the Utility Review Board. The estimated useful lives are as follows:

Structures	20-50 years
Utility plant other than structures and equipment	25-50 years
Equipment	5-10 years

(3) Allowance for Uncollectible Accounts

The Department provides an allowance for uncollectible accounts equal to estimated losses that will be incurred in collection of all receivables. The estimated losses are based on historical collection experience and a review of the current status of the outstanding receivables.

(4) Inventories

Inventories are stated at cost, first-in, first-out method.

NOTES TO FINANCIAL STATEMENTS (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

(5) Amortization of Deferred Loan Costs

Deferred loan costs are being amortized, on the straight-line method, over the life of the bonds.

(6) Compensated Absences

The costs of vacation pay granted to employees are recorded as expenditures when earned.

(7) Cash Equivalents

For purposes of the statement of cash flows, the Department considers all highly liquid investments (including restricted assets) purchased with an original maturity of three months or less to be cash equivalents.

(8) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(9) Capitalized Interest

Net interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

- (10) Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Department are charges to customers for sales and services. The Department also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for proprietary funds include the cost of sales and services, administrative and maintenance expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.**

- (11) As a general rule, when both restricted and unrestricted resources are available for use, it is the Department's policy to use restricted resources first, then unrestricted resources as they are needed.**

NOTES TO FINANCIAL STATEMENTS (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE C - UTILITY PLANT ADDITIONS AND RETIREMENTS

	<u>Balance</u> <u>June 30, 2007</u>	<u>Additions &</u> <u>Reclassifications</u>	<u>Retirements &</u> <u>Reclassifications</u>	<u>Balance</u> <u>June 30, 2008</u>
Capital assets not being depreciated or amortized				
Land and land rights	\$ 72,394.78	\$ 4,116.95		\$ 76,511.73
Construction in progress	<u>1,484,562.27</u>		<u>\$ 1,449,702.08</u>	<u>34,860.19</u>
Total capital assets not being depreciated or amortized	<u>\$ 1,556,957.05</u>	<u>\$ 4,116.95</u>	<u>\$ 1,449,702.08</u>	<u>\$ 111,371.92</u>
Other capital assets:				
General	\$ 200,371.27	\$ 9,300.76		\$ 209,672.03
Water	8,055,670.01	2,361,313.35	\$ 154,386.64	10,262,596.72
Sewer	1,685,323.63		486.00	1,684,837.63
Maintenance	178,088.42	46,424.26		224,512.68
Acquisition adjustment	<u>128,468.00</u>	<u>98,900.10</u>		<u>227,368.10</u>
Utility Plant	<u>\$ 10,247,921.33</u>	<u>\$ 2,515,938.47</u>	<u>\$ 154,872.64</u>	<u>\$ 12,608,987.16</u>
Less accumulated depreciation/amortization for:				
General	\$ 33,539.85	\$ 11,643.92		\$ 45,183.77
Water	1,267,424.59	248,215.73	\$ 69,507.79	1,446,132.53
Sewer	943,450.58	40,632.42	356.32	983,726.68
Maintenance	63,107.22	15,720.02		78,827.24
Acquisition Adjustment	5,364.95	7,846.15		13,211.10
Total accumulated depreciation/amortization	<u>\$ 2,312,887.19</u>	<u>\$ 324,058.24</u>	<u>\$ 69,864.11</u>	<u>\$ 2,567,081.32</u>
Other capital assets, net	<u>\$ 7,935,034.14</u>	<u>\$ 2,191,880.23</u>	<u>\$ 85,008.53</u>	<u>\$ 10,041,905.84</u>
Capital assets, net	<u>\$ 9,491,991.19</u>	<u>\$ 2,195,997.18</u>	<u>\$ 1,534,710.61</u>	<u>\$ 10,153,277.76</u>

NOTE D - CASH AND RESTRICTED FUNDS

The following is a summary of cash and restricted funds at June 30, 2008:

	<u>Cash Equivalents</u>	<u>Certificates of Deposit</u>	<u>Total</u>
Cash for general use:	\$ 92,187.70	\$51,716.16	\$143,903.86
Restricted funds:			
Construction account	14.12		14.12
Bond reserve fund	<u>23,000.65</u>	<u>55,000.00</u>	<u>78,000.65</u>
	<u>\$115,202.47</u>	<u>\$106,716.16</u>	<u>\$221,918.63</u>

The Bond Reserve fund is restricted for future bond and interest payments. The Department has also designated \$86,709.41 to be used to fund capital asset replacements.

Legal Provisions: All deposits with financial institutions must be secured by one of two methods depending on whether the financial institution participates in the bank collateral pool

NOTES TO FINANCIAL STATEMENTS (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE D - CASH AND RESTRICTED FUNDS (CONT'D)

administered by the state treasurer. Participating banks determine the aggregate balance of their public funds accounts for the State of Tennessee and its political subdivisions. The amount of collateral required to secure these public deposits must equal at least 105 percent of the average daily balance of public deposits held. Collateral securities required to be pledged by the participating banks to protect their public fund accounts are pledged to the state treasurer on behalf of the bank collateral pool. The securities pledged to protect these accounts are pledged in the aggregate rather than against each account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure. For deposits with financial institutions that do not participate in the bank collateral pool, state statutes require that all deposits be collateralized with collateral whose market value is equal to 105 percent of the uninsured amount of the deposits. The collateral must be placed by the depository bank in an escrow account in a second bank for the benefit of the Department.

Types of investments authorized: State statutes authorize the entity to make direct investments in bonds, notes, or treasury bills of the U.S. government and obligations guaranteed by the U.S. government or any of its agencies; bonds of any state or political subdivision rated A or higher by any nationally recognized rating service; the metropolitan government's own legally issued bonds or notes; the State Treasurer's Investment Pool; and repurchase agreements.

NOTE E - DUE FROM METROPOLITAN GOVERNMENT

The Metropolitan government has agreed to provide funding for a water service expansion project. At June 30, 2008, the Department had incurred \$32,835.59 toward this project for which it will be reimbursed by the Metropolitan government.

NOTE F - REVENUE BONDS

A summary of transactions for the year ended June 30, 2008, includes the following:

Balance - beginning of year	\$ 2,004,427.83
New bond	2,000,000.00
Bond payments	<u>(58,954.93)</u>
	\$ 3,945,472.90
Less current maturities	<u>(54,754.00)</u>
Revenue bonds, less current maturities - end of year	<u>\$ 3,890,718.90</u>

Details of water and sewer revenue bonds are as follows:

Series 1989 Sewer Revenue and Tax Bonds, 5%, payable \$1,530 per month including principal and interest with final maturity in 2009	\$ 4,197.72
Series 1992 Water Revenue and Tax Bonds, 6.625%, payable \$301 per month including principal and interest with final maturity in 2030	41,321.50

NOTES TO FINANCIAL STATEMENTS (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE F - REVENUE BONDS (CONT'D)

Series 1992A Water Revenue and Tax Bonds, 6.375%, payable \$138 per month including principal and interest with final maturity in 2029	19,125.85
Series 1994 Water Revenue and Tax Bonds, 5.5%, payable \$462 per month including principal and interest with final maturity in 2032	73,011.68
Series 1997 Water Revenue and Tax Bonds, 4.875%, payable \$1,459 per month including principal and interest with final maturity in 2036	263,476.02
Series 2000 Water Revenue and Tax Bonds, 4.75% payable \$1,711 per month including principal and interest with final maturity in 2038	327,129.99
Series 2001 Water Revenue and Tax Bonds, 4.75% payable \$1,012 per month including principal and interest with final maturity in 2040	198,522.63
Series 2006 Water Revenue and Tax Bonds, 4.25% payable \$4,652 per month including principal and interest with final maturity in 2045	1,033,538.97
Series 2008 Water Revenue and Tax Bonds, 4.12% payable \$8,700 per month Including principal and interest with final maturity in 2046	1,985,148.54
	<u>\$ 3,945,472.90</u>

The bonds are payable from and secured primarily by a pledge of the net revenues of the Department; in the event such revenues are insufficient, the bonds are further secured by the taxing power of the Metropolitan Government.

The annual requirements to amortize principal and interest for all revenue bonds as of June 30, 2008 are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 54,692.00	\$ 170,665.00
2010	52,779.00	168,357.00
2011	55,166.00	165,970.00
2012	57,666.00	163,470.00
2013	60,279.00	160,857.00
2014-2018	344,994.00	760,686.00
2019-2023	430,914.00	674,766.00
2024-2028	538,611.00	567,069.00
2029-2033	638,351.00	438,192.00
2034-2038	711,827.00	286,512.00
2039-2043	680,624.00	139,472.00
2044-2046	319,570.00	15,160.00
	<u>\$3,945,473.00</u>	<u>\$3,711,176.00</u>

NOTES TO FINANCIAL STATEMENTS (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE F - REVENUE BONDS (CONT'D)

Under provisions of the bond agreements, the Department is required to establish and maintain various funds as follows:

(a) Revenue Fund

All revenues are to be deposited in this fund and shall be disbursed for the establishment of the other required funds.

(b) Operation and Maintenance Fund

The money transferred from the revenue fund is to be deposited to this fund for payment of current expenses. The maximum balance of this fund shall not exceed one-fourth of the amount budgeted for current expenses for the fiscal year.

(c) Bond Funds

The next monies available are to be used to establish bond funds to be used to pay the principal and interest on the bonds as such payments are due. As part of the Bond Funds, Debt Service Reserve Accounts are also to be funded in the amount of \$4,221.00 for the 1989 series, \$3,612.00 for the 1992 series, \$1,656.00 for the 1992A Series, \$5,544.00 for the 1994 series, \$17,508.00 for the 1997 series, \$20,532.00 for the 2000 series, \$12,144.00 for the 2001 series, \$55,824.00 for the 2006 series, and \$104,316.00 for the 2008 series. All reserve accounts were funded as required at June 30, 2008.

As required by provisions of the bond agreements, the beginning and end of the year balances of the required funds are as follows:

	<u>June 30, 2008</u>	<u>June 30, 2008</u>
Revenue	\$210,179.67	\$142,187.70
Operation and Maintenance	1,634.44	1,716.16
Bond	67,743.25	78,000.65

NOTE G - NOTES PAYABLE

Interest rates and repayment schedules for loans the Department has with Farmers Bank are as follows:

	Office Building		2008 Dodge Truck	
	3.23%		2.63%	
Year Ending				
<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 12,079.38	\$ 1,980.90	\$ 9,109.79	\$ 607.44
2010	12,475.37	1,584.91	9,351.63	364.95
2011	12,884.34	1,175.94	8,802.21	116.03
2012	13,312.80	747.48		
2013	14,919.53	319.32		
2014	1,099.34	15.37		
	<u>\$ 66,770.76</u>	<u>\$ 5,823.92</u>	<u>\$27,263.63</u>	<u>\$ 1,088.42</u>

NOTES TO FINANCIAL STATEMENTS (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE G - NOTES PAYABLE (CONT'D)

Interest rates and repayment schedules for loans the Department has with Moore County Bank are as follows:

Year Ending June 30,	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 30,224.97	\$ 8,453.67	\$ 7,312.71	\$ 1,712.61
2010	31,315.58	7,363.06	7,524.39	1,500.93
2011	32,445.05	6,233.09	7,742.18	1,283.14
2012	33,615.39	5,061.63	7,964.90	1,060.42
2013	34,830.43	3,848.21	8,197.15	829.37
2014-2016	89,446.30	4,041.63	24,492.65	1,033.32
	<u>\$ 251,877.72</u>	<u>\$ 35,001.29</u>	<u>\$ 63,233.98</u>	<u>\$ 7,419.79</u>

The notes are secured by the full faith and credit of the Metropolitan Government of Lynchburg/Moore County and bear interest rates of 3.55% and 2.86% respectively.

Metropolitan Lynchburg-Moore County, Tennessee (the Primary Government) has borrowed under the State's revolving loan program for the Department's construction projects. The principal and interest payments required under the terms of the loan, which is secured by the Department's revenues and has a stated interest rate of 2.95%, are as follows:

	<u>Principal</u>	<u>Interest</u>
2009	\$ 37,174.68	\$ 22,273.32
2010	38,286.28	21,161.72
2011	39,431.13	20,016.87
2012	40,476.00	18,960.00
2013	41,688.00	17,748.00
2014-2018	227,916.00	69,312.00
2019-2023	264,096.00	33,132.00
2024-2025	83,961.20	2,052.00
Total	<u>\$773,029.29</u>	<u>\$204,655.91</u>

NOTES TO FINANCIAL STATEMENTS (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE G - NOTES PAYABLE (CONT'D)

The Department has purchased water lines from Lincoln County Utility Board and Winchester Utilities under agreements which require the following payments.

	Lincoln County Utility Board		Winchester Utilities	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Principal</u>
2009	\$ 20,833.34	\$ 2,500.00	\$ 18,103.20	\$ 14,206.32
2010	20,833.34	1,666.67	18,103.20	14,206.32
2011	20,833.30	833.34	18,103.20	14,206.32
2012			18,103.20	14,206.32
2013			18,103.20	14,206.32
2014-2018			60,343.60	67,480.12
Total	<u>\$ 62,499.98</u>	<u>\$ 5,001.01</u>	<u>\$ 150,859.60</u>	<u>\$ 138,511.72</u>

The obligations bear interest rates of 4% and 0%.

Notes payable activity for the year ended June 30, 2008, is as follows:

<u>Balance</u>			<u>Balance</u>
<u>June 30, 2007</u>	<u>Draws</u>	<u>Repayments</u>	<u>June 30, 2008</u>
\$3,148,237.51	\$ 536,462.59	\$2,150,653.42	\$1,534,046.68

The Department capitalized \$19,151.23 of interest cost during the current year.

NOTE H - RISK MANAGEMENT

The Department is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets, errors and omissions; injuries to employees; and natural disasters. The Department obtains insurance coverage covering the above risks of loss through a public risk entity pool, Tennessee Risk Management Trust (TRMT), which reinsures through commercial insurance companies for claims exceeding \$200,000.00 for each insured event. An annual loss fund is established based on TRMT's known losses. If this amount is exhausted, TRMT will pay the additional amount in self-insured retentions from surplus. If loss fund payments exceed available surplus, assessments to members could be possible. No estimate of any possible future assessments has been made.

Settled claims in the past three years have not exceeded the coverages.

NOTE I - INCOME TAXES

As a governmental entity, the Department is exempt from federal, state and local income taxes.

NOTES TO FINANCIAL STATEMENTS (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

NOTE J - SIGNIFICANT CONCENTRATIONS

The Department operates principally to distribute water to residents of Moore County, Tennessee. The Department grants credit to its customers, which at June 30, 2008, totaled \$86,382.89. Deposits from these customers, totaling \$20,361.11 at June 30, 2008, are held as security for these accounts receivable.

Water and sewer revenues from Jack Daniel Distillery account for approximately twenty percent of the Department's total water and sewer revenues.

NOTE K - ENVIRONMENTAL CONTINGENCY

The Department's facilities and operations are subject to a wide range of environmental protection laws related to the use and disposal of hazardous materials. As a result, there is the possibility that environmental conditions may arise which would require the Department to incur clean up costs. As in prior years, management continues its efforts to comply, and to determine compliance, with all applicable environmental protection laws and does not believe such costs, if any, would materially affect the Department's financial position or its future cash flows.

NOTE L - LOAN AND GRANT FUNDING

The Department has been approved for a \$558,000.00 loan and a \$192,000.00 grant to construct a 300,000 gallon elevated water storage tank and associated transmission lines.

SUPPLEMENTARY INFORMATION

STATEMENT OF INCOME - BUDGET AND ACTUAL
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

Year ended June 30, 2008

	Budget	Actual	Favorable (Unfavorable)
REVENUES			
Water sales	\$ 1,080,358.00	\$ 1,082,700.96	\$ 2,342.96
Surcharges	32,880.00	34,300.00	1,420.00
Sewer service charges	214,544.00	208,107.71	(6,436.29)
Penalties	12,000.00	14,920.00	2,920.00
Pre-treatment income	10,000.00	9,952.08	(47.92)
Miscellaneous	4,060.00	4,705.62	645.62
Service fees	12,000.00	12,150.00	150.00
Sanitation revenue	7,200.00	7,200.00	0.00
Tap connection fees	40,000.00	17,364.24	(22,635.76)
Uncollectible accounts	(2,000.00)	(2,446.80)	(446.80)
TOTAL REVENUES	\$ 1,411,042.00	\$ 1,388,953.81	\$ (22,088.19)
OPERATING EXPENSES			
General and administrative	\$ 252,127.67	\$ 249,669.03	\$ 2,458.64
Water operating expenses	646,118.53	655,702.98	(9,584.45)
Sewer operating expenses	138,000.00	139,473.63	(1,473.63)
Utility maintenance expenses	197,799.11	164,033.13	33,765.98
TOTAL OPERATING EXPENSES	\$ 1,234,045.31	\$ 1,208,878.77	\$ 25,166.54
Operating income	\$ 176,996.69	\$ 180,075.04	\$ 3,078.35
NONOPERATING INCOME (EXPENSE)			
Interest income	\$ 8,500.00	\$ 8,042.58	\$ (457.42)
Interest expense	(186,555.00)	(188,484.81)	(1,929.81)
Loss on retirement of fixed assets		(84,208.53)	(84,208.53)
Total nonoperating income (expense), net	\$ (178,055.00)	\$ (264,650.76)	\$ (86,595.76)
NET INCOME (LOSS) BEFORE CONTRIBUTIONS AND GRANTS	\$ (1,058.31)	\$ (84,575.72)	\$ (83,517.41)
Tap fees in excess of cost		18,992.86	
Contributions		46,486.27	
Grants		505,659.28	
		\$ 486,562.69	

See independent auditor's report.

SCHEDULE OF OPERATING EXPENSES - BUDGET AND ACTUAL
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

Year Ended June 30, 2008

	Budget	Actual	Favorable (Unfavorable)
GENERAL AND ADMINISTRATIVE:			
Salaries and wages	\$ 135,608.00	\$ 131,893.21	\$ 3,714.79
Payroll taxes and employee benefits	42,204.00	40,235.08	1,968.92
Telephone	5,780.00	5,062.08	717.92
Utilities	4,050.00	4,221.71	(171.71)
Depreciation and amortization	18,304.67	20,765.44	(2,460.77)
Insurance	1,000.00	1,000.00	-0-
Surety bond	330.00	330.00	-0-
Postage	8,500.00	8,856.33	(356.33)
Advertising	300.00	192.36	107.64
Office equipment service contract	4,750.00	4,713.00	37.00
Legal and professional fees	6,935.00	6,755.00	180.00
Maintenance and repair	1,750.00	2,698.49	(948.49)
Fuel	5,280.00	6,713.67	(1,433.67)
Supplies	9,668.00	9,188.97	479.03
General services	2,368.00	2,422.00	(54.00)
Vehicle maintenance and repair	3,500.00	2,876.09	623.91
Dues and subscriptions	1,425.00	1,420.40	4.60
Miscellaneous	375.00	325.20	49.80
GENERAL AND ADMINISTRATIVE	\$ 252,127.67	\$ 249,669.03	\$ 2,458.64
WATER:			
Plant operations:			
Salaries and wages	\$ 107,652.53	\$ 104,555.60	\$ 3,096.93
Payroll taxes and employee benefits	43,340.00	39,875.15	3,464.85
Telephone	3,300.00	3,048.02	251.98
Electricity	68,350.00	71,727.80	(3,377.80)
Treated water	39,600.00	41,642.40	(2,042.40)
Education	400.00	216.40	183.60
Chemicals	35,600.00	38,121.23	(2,521.23)
Depreciation	238,370.00	248,215.73	(9,845.73)
Maintenance and repair	2,500.00	5,215.64	(2,715.64)
Raw water	16,176.00	16,238.43	(62.43)
Postage	50.00	60.01	(10.01)
Engineering fee	520.00	1,070.00	(550.00)
Advertising	200.00	622.88	(422.88)
Insurance	13,650.00	13,643.50	6.50
Lab expense	4,400.00	3,249.50	1,150.50
State fees	2,500.00	2,329.00	171.00
Miscellaneous supplies	3,800.00	3,799.31	0.69
Subscriptions and dues	610.00	600.95	9.05
	\$ 581,018.53	\$ 594,231.55	\$ (13,213.02)
Distribution:			
Electricity	\$ 16,900.00	\$ 16,565.07	\$ 334.93
Meters and parts	3,200.00	4,182.94	(982.94)
Maintenance and repair	24,900.00	22,219.26	2,680.74
Tap connection and construction expense	19,000.00	16,976.32	2,023.68
Engineering fee	500.00	595.00	(95.00)
Lab fees	300.00	320.00	(20.00)
Miscellaneous supplies	300.00	612.84	(312.84)
	\$ 65,100.00	\$ 61,471.43	\$ 3,628.57
WATER OPERATING EXPENSES	\$ 646,118.53	\$ 655,702.98	\$ (9,584.45)

See independent auditors' report.

SCHEDULE OF OPERATING EXPENSES - BUDGET AND ACTUAL (CONT'D)
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

Year Ended June 30, 2008

	Budget	Actual	Favorable (Unfavorable)
SEWER:			
Plant Operations:			
Salaries and wages	\$ 31,895.00	\$ 33,312.43	\$ (1,417.43)
Payroll taxes and employee benefits	4,805.00	5,019.30	(214.30)
Telephone	1,400.00	1,348.38	51.62
Electricity	21,000.00	22,541.91	(1,541.91)
General services	175.00	175.00	-0-
Chemicals	7,700.00	6,295.26	1,404.74
Depreciation	40,675.00	40,632.42	42.58
Maintenance and repair	3,200.00	2,481.46	718.54
Vehicle maintenance and repair	100.00	255.98	(155.98)
Insurance	3,500.00	3,500.00	-0-
Postage	50.00	2.28	47.72
Engineering	3,025.00	3,025.00	-0-
Miscellaneous supplies	1,300.00	1,439.77	(139.77)
Fuel	75.00	-0-	75.00
State fees	2,650.00	1,325.00	1,325.00
Pre-treatment expense	5,000.00	5,388.40	(388.40)
	<u>\$ 126,550.00</u>	<u>\$ 126,742.59</u>	<u>\$ (192.59)</u>
Collection:			
Electricity	\$ 8,700.00	\$ 8,577.46	\$ 122.54
Maintenance and repair	2,000.00	3,678.66	(1,678.66)
Meters and assembly parts	-0-	87.00	(87.00)
Tap connections	750.00	387.92	362.08
	<u>\$ 11,450.00</u>	<u>\$ 12,731.04</u>	<u>\$ (1,281.04)</u>
SEWER OPERATING EXPENSES	<u>\$ 138,000.00</u>	<u>\$ 139,473.63</u>	<u>\$ (1,473.63)</u>
UTILITY MAINTENANCE			
Salaries and wages	\$ 113,981.30	\$ 106,393.09	\$ 7,588.21
Payroll taxes and employee benefits	44,300.00	43,554.05	745.95
Insurance	2,620.00	2,611.50	8.50
Maintenance and repair	-0-	73.11	(73.11)
Education	190.00	182.36	7.64
Vehicle maintenance and repair	3,500.00	6,500.81	(3,000.81)
Depreciation	16,457.81	15,720.02	737.79
Fuel	6,200.00	7,563.70	(1,363.70)
Miscellaneous supplies	7,050.00	7,900.49	(850.49)
Utility maintenance tools	2,500.00	2,214.63	285.37
Equipment rental	1,000.00	-0-	1,000.00
Allocable expenses	-0-	(28,680.63)	28,680.63
UTILITY MAINTENANCE EXPENSES	<u>\$ 197,799.11</u>	<u>\$ 164,033.13</u>	<u>\$ 33,765.98</u>
TOTAL OPERATING EXPENSES	<u>\$ 1,234,045.31</u>	<u>\$ 1,208,878.77</u>	<u>\$ 25,166.54</u>

See independent auditors' report.

SCHEDULE OF REVENUE BOND PRINCIPAL AND INTEREST REQUIREMENTS

**METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT**

June 30, 2007

Year Ending June 30,	Series 1989		Series 1992		Series 1992A		Series 1994		Series 1997	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2009	\$ 4,198	\$ 23	\$ 904	\$ 2,708	\$ 460	\$ 1,196	\$ 1,584	\$ 3,960	\$ 4,776	\$ 12,732
2010			966	2,646	490	1,166	1,673	3,871	5,014	12,494
2011			1,031	2,581	522	1,134	1,767	3,777	5,264	12,244
2012			1,102	2,510	557	1,099	1,867	3,677	5,526	11,982
2013			1,177	2,435	593	1,063	1,972	3,572	5,802	11,706
2014			1,258	2,354	632	1,024	2,084	3,460	6,091	11,417
2015			1,343	2,269	673	983	2,201	3,343	6,395	11,113
2016			1,435	2,177	718	938	2,325	3,219	6,714	10,794
2017			1,533	2,079	765	891	2,456	3,088	7,048	10,460
2018			1,638	1,974	815	841	2,595	2,949	7,400	10,108
2019			1,750	1,862	868	788	2,741	2,803	7,768	9,740
2020			1,869	1,743	926	730	2,896	2,648	8,156	9,352
2021			1,997	1,615	986	670	3,059	2,485	8,562	8,946
2022			2,133	1,479	1,051	605	3,232	2,312	8,989	8,519
2023			2,279	1,333	1,120	536	3,414	2,130	9,437	8,071
2024			2,435	1,177	1,194	462	3,607	1,937	9,908	7,600
2025			2,601	1,011	1,272	384	3,810	1,734	10,402	7,106
2026			2,779	833	1,355	301	4,025	1,519	10,920	6,588
2027			2,968	644	1,444	212	4,252	1,292	11,465	6,043
2028			3,171	441	1,539	117	4,492	1,052	12,036	5,472
2029			3,388	224	1,146	22	4,746	798	12,636	4,872
2030			1,564	26			5,013	531	13,266	4,242
2031							5,296	248	13,928	3,580
2032							1,905	16	14,622	2,886
2033									15,351	2,157
2034									16,116	1,392
2035									16,920	588
2036									2,964	11
2037										
2038										
2039										
2040										
2041										
2042										
2043										
2044										
2045										
2046										
	\$ 4,198	\$ 23	\$ 41,321	\$ 36,121	\$ 19,126	\$ 15,162	\$ 73,012	\$ 56,421	\$ 263,476	\$ 212,215

See independent auditors' report.

Series 2000		Series 2001		Series 2006		Series 2008		Totals	
Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
\$ 5,105	\$ 15,427	\$ 2,774	\$ 9,370	\$ 12,040	\$ 43,784	\$ 22,851	\$ 81,465	\$ 54,692	\$ 170,665
5,353	15,179	2,909	9,235	12,562	43,262	23,812	80,504	52,779	168,357
5,613	14,919	3,050	9,094	13,106	42,718	24,813	79,503	55,166	165,970
5,885	14,647	3,199	8,945	13,674	42,150	25,856	78,460	57,666	163,470
6,171	14,361	3,354	8,790	14,267	41,557	26,942	77,374	60,278	160,858
6,471	14,061	3,517	8,627	14,885	40,939	28,076	76,240	63,014	158,122
6,785	13,747	3,687	8,457	15,530	40,294	29,256	75,060	65,870	155,266
7,114	13,418	3,866	8,278	16,203	39,621	30,486	73,831	68,861	152,275
7,460	13,072	4,054	8,090	16,905	38,919	31,767	72,549	71,988	149,148
7,822	12,710	4,251	7,893	17,638	38,186	33,103	71,213	75,262	145,874
8,202	12,330	4,457	7,687	18,402	37,422	34,494	69,822	78,682	142,454
8,600	11,932	4,674	7,470	19,200	36,624	35,944	68,372	82,265	138,871
9,017	11,515	4,901	7,243	20,032	35,792	37,455	66,861	86,009	135,127
9,455	11,077	5,138	7,006	20,900	34,924	39,030	65,286	89,928	131,208
9,914	10,618	5,388	6,756	21,806	34,018	40,671	63,645	94,029	127,107
10,395	10,137	5,649	6,495	22,751	33,073	42,381	61,935	98,320	122,816
10,900	9,632	5,924	6,220	23,737	32,087	44,162	60,154	102,808	118,328
11,429	9,103	6,211	5,933	24,766	31,058	46,019	58,297	107,504	113,632
11,984	8,548	6,513	5,631	25,839	29,985	47,953	56,363	112,418	108,718
12,566	7,966	6,829	5,315	26,959	28,865	49,969	54,347	117,561	103,575
13,176	7,356	7,161	4,983	28,127	27,697	52,070	52,246	122,450	98,198
13,816	6,716	7,508	4,636	29,346	26,478	54,159	50,157	124,672	92,786
14,486	6,046	7,873	4,271	30,618	25,206	56,540	47,776	128,741	87,127
15,190	5,342	8,255	3,889	31,945	23,879	55,917	48,399	127,834	84,411
15,927	4,605	8,656	3,488	33,329	22,495	61,393	42,923	134,656	75,668
16,700	3,832	9,076	3,068	34,774	21,050	63,974	40,342	140,640	69,684
17,511	3,020	9,517	2,627	36,281	19,543	66,664	37,652	146,893	63,430
18,361	2,171	9,979	2,165	37,853	17,971	69,466	34,850	138,623	57,168
19,252	1,280	10,463	1,681	39,493	16,331	72,387	31,929	141,595	51,221
16,469	331	10,971	1,173	41,205	14,619	75,430	28,886	144,075	45,009
		11,504	540	42,991	12,833	78,601	25,715	133,096	39,088
		7,215	108	44,854	10,970	81,905	22,411	133,974	33,489
				46,797	9,027	85,348	18,968	132,145	27,995
				48,826	6,998	88,936	15,380	137,762	22,378
				50,942	4,882	92,675	11,641	143,617	16,523
				53,149	2,675	96,570	7,746	149,719	10,421
				31,807	757	100,630	3,686	132,437	4,443
						37,444	297	37,444	297
\$ 327,129	\$ 285,098	\$ 198,523	\$ 185,164	\$ 1,033,539	\$ 1,008,689	\$ 1,985,149	\$ 1,912,284	\$ 3,945,473	\$ 3,711,177

RATES AND STATISTICAL DATA
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

WATER RATES

First 2,000 gallons	\$20.35
All over 2,000 gallons	\$6.70/per 1,000

SEWER RATES

First 2,000 gallons	\$12.79
All over 2,000 gallons	\$6.39/per 1,000

Number of customers at June 30, 2008:

Water	2,138
Sewer	314

Schedule of Unaccounted for Water

Gallons of water:

Pumped, bought	190,076,000
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Water accounted for:

Sold	139,168,606
Flushing, leaks, water and sewer plant use	15,437,373
Fire, other	325,650

Unaccounted for water	35,144,371
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Percentage of unaccounted for water	18%
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See independent auditors' report.

SCHEDULE OF INSURANCE
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

Property	\$7,578,089.00
General Liability:	
Per occurrence for loss not limited by the tort liability act	1,000,000
Workman's Compensation	Statutory
Employers' Liability	1,000,000
Commercial Crime:	
Employee fidelity, depositors' forgery, and money orders and counterfeit papers	150,000
Business Auto:	
Liability - per occurrence for loss limited by the tort liability act	1,000,000
Physical damage	ACV
Public Official Liability (Errors or Omissions)	1,000,000
Electronic Data Processing	500,000
Boiler and machinery	5,000,000

See independent auditors' report.

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND STATE FINANCIAL ASSISTANCE
METROPOLITAN LYNCHBURG-MOORE COUNTY WATER AND SEWER DEPARTMENT**

Year ended June 30, 2008

Grantor Agency	Program Name	CFDA Number
<u>FEDERAL AWARDS</u>		
United States Department of Agriculture Rural Development	Water and Waste Disposal Systems for Rural Communities	10.760

The schedule is presented using the accrual basis of accounting.

Beginning (Accrued) Deferred	Cash Receipts	Expenditures	Ending (Accrued) Deferred
\$ (229,803.93)	\$ 875,972.93	\$ 649,619.28	\$ (3,450.28)

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Members of Utility Board
Metropolitan Lynchburg - Moore County
Water and Sewer Department
Lynchburg, Tennessee

We have audited the accompanying financial statements of Metropolitan Lynchburg - Moore County Water and Sewer Department (the Department) as of and for the year ended June 30, 2008, and have issued our report thereon dated October 20, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Department's financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control. We consider the following deficiency to be a significant deficiency in internal control over financial reporting.

Condition, Criteria, Cause and Effect: The Department does not employ anyone with training in preparing financial statements for external reporting in accordance with generally accepted accounting principles.

Recommendation: Management of the Department should determine whether it would be feasible to train or hire someone to be able to prepare financial statements in accordance with generally accepted accounting principles.

Management Response: At this time we do not believe the benefit of addressing this control deficiency would exceed the cost.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the deficiency described above is a material weakness.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Metropolitan Lynchburg - Moore County Water and Sewer Department's response to the finding identified in our audit is described above. We did not audit Metropolitan Lynchburg - Moore County Water and Sewer Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Utility Board, management, Metropolitan Council and oversight agencies and is not intended to be and should not be used by anyone other than these specified parties.

Winnett Associates

October 20, 2008

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB *CIRCULAR A-133***

Members of Utility Board
Metropolitan Lynchburg - Moore County
Water and Sewer Department
Lynchburg, Tennessee

Compliance

We have audited the compliance of Metropolitan Lynchburg – Moore County Water and Sewer Department (the Department) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The Department's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2008.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with the requirements that could have a direct and material effect on a

major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Entity's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Winnett Associates

October 20, 2008

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
METROPOLITAN LYNCHBURG - MOORE COUNTY
WATER AND SEWER DEPARTMENT

June 30, 2008

I. Summary of auditors' results:

Type of report issued on the financial statements - unqualified

The audit disclosed no noncompliance, which is material to the financial statements of the auditee.

Type of report issued on compliance for major programs - unqualified

The audit disclosed no audit findings required to be reported under Section - .510.

Major program: Water and Waste Disposal Systems for Rural Communities

The threshold for distinguishing Types A and B programs was \$300,000.00.

Metropolitan Lynchburg-Moore County Water and Sewer Department was not determined to be a low-risk auditee.

II. The audit of the financial statements of the Metropolitan Lynchburg-Moore County Water and Sewer Department disclosed a material weakness in internal control.

III. Findings and questioned costs for Federal awards - none

WINNETT

Associates, PLLC

Certified Public Accountants and Consultants

514 Elm Street, P. O. Box 745
Shelbyville, Tennessee 37162

Members of Utility Board
Metropolitan Lynchburg - Moore County
Water and Sewer Department
Lynchburg, Tennessee

We have audited the financial statements of Metropolitan Lynchburg - Moore County Water and Sewer Department for the year ended June 30, 2008, and have issued our report thereon dated October 20, 2008. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated June 20, 2008, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements presented by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Metropolitan Lynchburg - Moore County Water and Sewer Department are described in Note B to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2008. We noted no transactions entered into by the Department during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all misstatements having audit significance, such as accrual or deferral adjustments.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 20, 2008.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Department's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Members of Utility Board and management of Metropolitan Lynchburg - Moore County Water and Sewer Department and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink that reads "Winnett Associates". The script is cursive and fluid, with the first letter of "Winnett" being a large capital 'W' and "Associates" written in a similar cursive style.

WINNETT ASSOCIATES, PLLC

October 20, 2008